

The bill of exchange: a quiet revolution

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The most important instrument of the medieval fairs was a simple document: the bill of exchange. Its invention, which was gradual, goes back to the Italian merchants of the thirteenth and fourteenth centuries.¹ Its principle is simple; its effects were immense.

In its classic form, the bill of exchange involves four persons. The remitter hands over a sum of money, in a given currency and at a given place, to the drawer. In return, the drawer writes a letter in which he orders a correspondent, the payer, established in another town, to pay an equivalent sum, in the currency of that town, to the payee, who represents the remitter. Payment has to be made at a fixed maturity, often determined by custom — the “usance” — according to the distance between the two places.

Party	Role	Example
Remitter	hands over funds at the place of issue	a Florentine merchant who wants to have funds available in Geneva
Drawer	receives the funds and draws the bill	a Florentine company with a branch in Geneva
Payer	pays the bill at the place of payment	the Geneva branch of that company
Payee	receives payment	the remitter’s factor present at the Geneva fair

The bill of exchange performed three functions at once. First, it made it possible to transfer funds from one town to another without carrying coin, which reduced the risk of theft and the cost of transport. Second, it made it possible to convert one currency into another, since the sum handed over and the sum paid were expressed in different currencies. Third, it made it possible to extend credit, since an interval separated the handing over of the funds from their payment.

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It was this third function that raised a moral and legal problem. The Church prohibited lending at interest, which it classed as usury. Yet the bill of exchange often contained an implicit return for the remitter, built into the exchange rates applied. Theologians and canonists nevertheless accepted that exchange was lawful, reasoning that it amounted to the purchase of money in another place and carried a genuine risk arising from fluctuations in the rates. “Real” exchange, based on an actual transfer between two places, was thus tolerated. “Dry” exchange, which simulated a transfer in order to conceal a loan, was condemned.²

In practice, the boundary was porous. A common operation consisted in drawing a bill on a fair and then, at maturity, having a new bill drawn in the opposite direction, back to the place of origin. The remitter thus recovered his funds in his own town, increased by a return that resulted from the difference between the exchange rates of the two places. This mechanism of “rechange” made it possible to earn a return on credit while complying, in appearance, with the doctrine.³

Worked example. A Florentine merchant hands 1,000 florins to a Florentine company, which draws a bill payable at the next Geneva fair in the local currency, at the rate of the day. At the fair, the merchant’s factor collects the amount and immediately hands it to another company against a bill payable in Florence. Six months after the initial transaction, the merchant collects 1,030 florins in Florence. The difference between the exchange rates of the two places has given him a return of 3 per cent in six months, or about 6 per cent a year, without any loan contract having been concluded. The figures are fictitious; the mechanism illustrates how exchange incorporated interest-bearing credit.

The bill of exchange transformed the European economy. It allowed merchants to work with distant correspondents, to finance commercial operations over several months and to mobilise capital on a continental scale. It also created a demand for specialised services: one had to know the exchange rates of the various places, assess the creditworthiness of drawers and payers, organise presentations and payments, and handle protests in the event of refusal. The Italian bankers became the masters of these services.

The fairs played a central role in this system. Because they periodically brought together a large number of merchants and bankers, they served as the preferred places of payment for bills of exchange. A bill drawn in Bruges, Barcelona or Venice could be payable at a Geneva fair. The exchange rates applied at the fair served as a reference. The fair thus

became an international money market, in the sense that the supply of and demand for credit and currencies from different places met there.

Later, from the seventeenth century onwards, the practice of endorsement would make it possible to pass a bill of exchange from one holder to another, turning the bill into a genuine instrument of circulation.⁴ Modern negotiable instruments — the bill of exchange, the promissory note, the cheque — are its direct descendants. Swiss law on securities, codified in the Code of Obligations, still bears the trace of this long history.

1 Notes

1. Raymond de Roover, *L'évolution de la lettre de change, XVe-XVIIIe siècles*, preface by Fernand Braudel, Paris, Armand Colin (École pratique des hautes études, VIe section, Affaires et gens d'affaires, 4), 1953, 240 pp. ↩
2. Raymond de Roover, *L'évolution de la lettre de change, XVe-XVIIIe siècles*, preface by Fernand Braudel, Paris, Armand Colin (École pratique des hautes études, VIe section, Affaires et gens d'affaires, 4), 1953, 240 pp. ↩
3. Raymond de Roover, *L'évolution de la lettre de change, XVe-XVIIIe siècles*, preface by Fernand Braudel, Paris, Armand Colin (École pratique des hautes études, VIe section, Affaires et gens d'affaires, 4), 1953, 240 pp. ↩
4. Dictionnaire historique de la Suisse (DHS), art. "Lettre de change" (Körner, Bergier): endorsement, which makes the bill negotiable, appears in Italy in the fifteenth century but does not become general until the end of the sixteenth century; in the eighteenth century, the bill of exchange gradually gives way to discounting and to the cheque. ↩

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